IN THE

Supreme Court of the United States

October Term, 1973
No. 73-883

FRANKLIN STEEL PRODUCTS, INC.,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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SUBJECT INDEX

	Page
Opinion Below	1
Jurisdiction	2
Questions Presented	2
Regulations Involved	3
Statement of the Case	4
Reasons Why Certiorari Should Be Granted	9
1. The Standards Invoked by the Ninth Circuit for Determining Latent Defects Sharply Conflicts With Those Utilized by Other Federal Courts and by Federal Agencies Having Recurring Dealings Therewith; and Thereby Presents a Substantial Federal Question Involving the Correct Interpretation of Contract Provisions Required and Delineated by Procurement Regulations	9
2. The Ninth Circuit's Construction of the Inspection and Acceptance Clause Is Ambiguous, Confusing and Unreasonable, and Applies a Double-Standard Detrimental to Future Contractual Relations Between Government and Private Industry	13
3. The Ninth Circuit's Opinion Presents a Substantial Question, as Yet Undecided by This Court, as to the Force and Effect to Be Given a Federal Regulation in Construing a Contravening Contractual Provision	15
Conclusion	17

INDEX TO APPENDICES

Page

Appendix A. Opinion of the United States Court of Appeals for the Ninth Circuit .....App. p. 1

Appendix B. Findings of Fact and Conclusions of Law 8

Appendix C. Order 14

TABLE OF AUTHORITIES CITED

Cases	Page
Action Diamond Tool Co., (5/25/51) ASBCA No. 625, 5 CCF 51,887	12
Barrett & Co. v. Panther Rubber Mfg. Co., 1st Cir., 1928, 24 F.2d 329	9
G. L. Christian and Associates v. United States, Ct. of Cl., 1963, 312 F.2d 418; reh'g. denied, 320 F.2d 345; cert. denied, 375 U.S. 954	8, 12, 15, 16
Dixie Printing Ink Co., Appeal of, B.C.A. No. 896 (10/28/52)	11
General American Transportation Corp. v. Sun Insurance Office Ltd., E.D. Tenn., 1965, 239 F. Supp. 844	10
J. W. Bateson Co., Inc., Appeal of, B.C.A. No. 5479 (3/29/66) 66-1 B.C.A. 25,670; 25,677 (1966)	11
McQuagge v. United States, W.D. La., 1961, 197 F.Supp. 460	11
Moran Bros., Inc. v. United States, Ct. of Cl., 1965, 346 F.2d 590	16
Reading Steel Castings Co. v. United States, 268 U.S. 186 (1925)	14
Southwest Welding & Mfg. Co. v. United States, Ct. of Cl., 1969, 413 F.2d 1167	11
Walling v. General Industries Co., 330 U.S. 545 (1947)	17
Waterman Steamship Corp. v. United States Smelting, Refining & Mining Co., 5th Cir., 1946, 155 F.2d 687	10

Regulations — Page

Armed Services Procurement Regulations, Sec. 14.001-3, 32 F.R. 16409 10

Armed Services Procurement Regulations, Sec. 14.001-4 10

Armed Services Procurement Regulations, Sec. 14.100-1, 32 F.R. 8194 10

Armed Services Procurement Regulations, Sec. 14.100-2 10

Navy Procurement Regulations, Sec. 7.103-5, 32 C.F.R. 486 (1/1/72) 13

Navy Procurement Regulations, Sec. 7-105.51 ....3, 15

Rules

Rules of Civil Procedure, Rule 52(a) 17

Statute

United States Code, Title 28, Sec. 1254(1) 2

Textbooks

Borden, Effect of the Warranty Clause in Government Supplied Contracts, 20 Fed. B.J. 151, 152 (n.5) (1960) 11

McBride & Wachtel, Government Contracts—Law, Administration, Procedure (Matthew Bender, 1973, Vol. III, para. 27.60[1], pp. 27-100-27-102 11

McBride & Wachtel, Government Contracts—Law, Administration, Procedure (Matthew Bender, 1973), Vol. III, para. 27.60[1], pp. 27-103 12

Navy Contract Law, 2d Ed., 1959 (Navexos P-1995), Sec. 933, p. 556 15

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UNITED STATES OF AMERICA,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioner Franklin Steel Products, Inc., respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on July 16, 1973, reversing judgment of the United States District Court for the Central District of California.

Opinion Below.

The opinion of the Court of Appeals, reported in 482 F.2d 400 (1972), appears in Appendix A, hereto.

No opinion was rendered by the District Court for the Central District of California. However, said Court did make file and enter findings of fact and conclusions of law which are set forth in Appendix B hereto.

Jurisdiction.

The judgment of the Court of Appeals for the Ninth Circuit was entered on July 16, 1973.

Petitioner filed a timely Petition for Rehearing which was denied by said Court on September 10, 1973. A certified copy of said Order is included in Appendix C, hereto. This petition for certiorari is filed within ninety (90) days of the latter date.

This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

Questions Presented.

1. Whether, under a military procurement contract requiring that all bearings delivered thereunder be subjected to 100% final government inspection for conformance to specifications required in the manufacture of such bearings, the Government, by accepting same without adequate inspection, waived objections to defects in said bearings which were discoverable by performing upon them simple, inexpensive, non-destructive tests.

2. Whether a valid, mandatory Navy procurement regulation forbidding inclusion of warranty clauses in fixed-price supply contracts supersedes a warranty clause contained in such contract, thereby precluding an action for breach of warranty brought by the government nearly six years after the alleged breach.

Regulations Involved.

Navy Procurement Directive 7-105.51

"7-105.51 *Guaranty Clause*

"(a) The clause set forth below is approved for use in fixed-price supply contracts where general guaranty provisions are deemed desirable by the contracting officer . . . The approval of such provisions shall not be construed as prohibiting the use of performance guaranties or other special guaranty provisions.

"GUARANTY.

"The Contractor guarantees that at the time of delivery thereof the supplies provided for under this contract will be free from any defects in material or workmanship and will conform to the requirements of this contract. Notice of any such defect or nonconformance shall be given by the Government to the Contractor within one year of the delivery of the defective or nonconforming supplies. * * * If the Government does not require correction or replacement of defective or nonconforming supplies, the Contractor, if required by the Contracting Officer within a reasonable time after the notice of defect or nonconformance, shall repay such portion of the contract price of the supplies as is equitable in the circumstances.

"(b) When inspection and acceptance tests will afford full protection to the Government in ascertaining conformance to specifications and the absence of defects and deficiencies, no guaranty provision for that purpose shall be included in the contract. . . ."

Statement of the Case.

Petitioner, a corporation, dealing in surplus aircraft engine parts, entered into two written contracts on July 30 and August 23, 1962, calling for petitioner to sell and deliver to respondent's O&R Shop at Jacksonville Naval Air Station 321 new and unused Wright's Aeronautical Engine Curtis-Wright Master Bearings of a specified type, design and part number, for a total contract price of $27,285.00.

Because petitioner was not a manufacturer of engine parts or bearings, a special inspection clause was inserted into the contracts providing, in pertinent part, as follows:

> "*Inspection and Acceptance.*
>
> "* * *
>
> "At destination all delivered articles shall be subjected for 100% final inspection by the O&R Shop for conformance to the applicable data, drawings and specifications required in the manufacture of said articles. Inspection shall include magnaflux or zyglo or the equivalent thereof . . ."

The Government Contracting Officer who drafted the foregoing provision, testified that the "100% final inspection" clause was intended to require the Government to perform, before acceptance, simple, inexpensive, non-destructive tests on the bearings; and that the inspection and acceptance clauses set forth in the contract afforded the government full protection for ascertaining conformance to specifications and the absence of defects and deficiencies.

The contract, also contained a standard inspection clause which read, in pertinent part:

> "5. *INSPECTION*
>
> * * *
>
> (d) The inspection and test by the Government of any supplies or lots thereof does not relieve the Contractor from any responsibility concerning defects or other failures to meet the contract requirements which may be discovered prior to acceptance. Except as otherwise provided in this contract, acceptance shall be conclusive except as regards latent defects, fraud, or such gross mistakes as amounts to fraud."

The contracts also provided for a warranty of adherence to contract drawings and specifications at time of delivery, which, in the event of a breach thereof, afforded respondent the option of requiring replacement or correction of the defective articles at the contractor's expense, or recovering payment of an equitable portion of the contract price.[1]

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[1]The adherence warranty was contained in paragraph 33 of the contract which reads, in pertinent part, as follows:

> "(a) Notwithstanding inspection and acceptance by the Government of articles furnished under this contract concerning the conclusiveness thereof, the Contractor warrants that at the time of delivery (i) all materials delivered under this contract will be free from defects in material or wokmanship and will conform with the specifications, and all other requirements of this contract; . . .
>
> "(b) Within one year after the delivery of any article under this contract, written notice may be given by the Government to the Contractor of any breach of the warranties in paragraph (e) of this clause as to such article. Within a reasonable time after such notice, the Contracting Officer may either (i) require the prompt correction or re-

(This footnote is continued on next page)

. . . Said remedies were made exclusive except as to any "breach" involving latent defects, fraud, or such gross mistakes as amounts to fraud."[2]

Petitioner delivered the required number of bearings at the designated delivery point sometime prior to December 1, 1962. Unbeknown to petitioner, none of the bearings delivered adhered to the data, drawings or specifications prescribed by the contracts; and in fact, all of them bore an erroneous part number.

Subsequent to delivery, respondent accepted and installed said bearings in aircraft engines, and paid petitioner the contract price. Approximately eight months later, said bearings were found to have several visible discrepancies, as well as deficiencies in tin content and hardness. The Government thereafter replaced said bearings at a purported cost of $147,060.

All of the discrepancies were, upon delivery for conformance, readily discoverable by visual inspection.

Each of said deficiencies was readily discoverable, upon delivery of the bearings for conformance, by sub-

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placement of any article or part thereof (including preservation, packaging, packing, and marking) that did not at the time of delivery conform with the requirements of this contract within the meaning of paragraph (a) of this clause, or thereafter does not so conform in consequence of any such breach; or (ii) retain such article, whereupon the contract price thereof shall be reduced by an amount equitable under the circumstances and the Contractor shall promptly make appropriate repayment . . ."

[2]Paragraph 33(e) of the Contract reads, in its entirety

"(e) The remedies afforded the Government by paragraph (b) of this clause shall be exclusive as to any breach of the warranties in paragraph (a) of this clause, except any such breach involving latent defects, fraud or such gross mistakes as amount to fraud."

jecting them to simple, inexpensive, non-destructive tests.

In November, 1968, nearly six years after delivery of the bearings, the Government brought an action against petitioner for breach of the express warranty in the United States District Court for the Central District of California, in which it sought recovery of the purchase price ($27,285.00) plus consequential damages for retrofit ($147,060).

Following a two-day nonjury trial, the District Court, the Honorable Robert J. Kelleher, Judge Presiding, gave judgment for petitioner, based on the Court's finding that although the bearings were defective and did not conform to contract specifications, such defects were discoverable by reasonable tests; that the Government had waived such defects by failing to conduct such tests as required by the Inspection and Acceptance clause; and that therefore, the Government was foreclosed from recovery of damages by acceptance and use of the bearings without adequate inspection.

On appeal, the United States Court of Appeals for the Ninth Circuit reversed the judgment of the District Court and directed judgment for respondent for both the contract price and consequential damages, totaling $174,345.00.

Disregarding the evidence and the District Court's findings based thereon, the Court of Appeal held that the defects in the bearings were latent because not visually apparent; and although discoverable by simple,

inexpensive, non-destructive tests, the Government was not obligated to perform such tests because the latter were not specifically mentioned in the contract.

The Appellate Court also refused to hold that the warranty clause, on which respondent's action was founded, was superseded under the *Christian* Doctrine[3] by a Naval regulation forbidding its inclusion in the contract when inspection procedures afforded the government equivalent protection.

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[3]*G. L. Christian and Associates v. United States*, Ct. of Cl., 1963, 312 F.2d 418; re hearing denied, 320 F.2d 345; cert. denied, 375 U.S. 954.

REASONS WHY CERTIORARI SHOULD BE GRANTED.

1. The Standards Invoked by the Ninth Circuit for Determining Latent Defects Sharply Conflicts With Those Utilized by Other Federal Courts and by Federal Agencies Having Recurring Dealings Therewith; and Thereby Presents a Substantial Federal Question Involving the Correct Interpretation of Contract Provisions Required and Delineated by Procurement Regulations.

Whether a defect is latent or patent usually determines which party to a sales contract must bear responsibility for repair or replacement of, or damages and injury resulting from an article containing an undiscovered defect at time of acceptance.

Therefore, all parties have a substantial interest in the prompt discovery of defective supplies in order to avoid, or at least minimize the consequences of oversight.

Scientific and technological progress has afforded industry (and government) with what are often simple, inexpensive inspection techniques and procedures to aid in prompt detection of non-visual defects. That the employment of such procedures is universally accepted and anticipated is reflected in numerous federal court and administrative decisions, as well as in government procurement regulations.

As early as 1928, the First Circuit recognized latent defects as those not discoverable by "reasonable testing", and by the "exercise of ordinary experiment" (*Barrett & Co. v. Panther Rubber Mfg. Co.*, 1st Cir., 1928, 24 F.2d 329, 336). Similarly, the Fifth Circuit has defined a latent defect as one "that could not be

discovered by any known or customary test" (*Waterman Steamship Corp. v. United States Smelting, Refining & Mining Co.*, 5th Cir., 1946, 155 F.2d 687, 691; see also: *General American Transportation Corp. v. Sun Insurance Office Ltd.*, E.D. Tenn., 1965, 239 F.Supp. 844, 846).

For years preceding and since the execution of the contracts at bar, Armed Services Procurement Regulations have considered testing as an "element of inspection", involving "the application of established scientific principles and procedures."[4]

Moreover, at the time of delivery of the bearings here in question, procurement regulations expressly required inspection and testing "*in all cases prior to acceptance.*" (Emphasis supplied.)[5]

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[4]See: §14.001-3, 32 F.R. 16409 (11/30/67) (formerly §14.100-1, 32-F.R. 8194 [8/26/1960]) defining *inspection* as follows: "Inspection means the examination and testing of supplies or services (including, when appropriate, raw materials, components, and intermediate assemblies) to determine whether they conform to contract requirements."

§14.001-4 (*ibid.*) (formerly §14.100-2 [*ibid.*] defining *testing*, states: "Testing is an element of inspection and generally denotes the determination by technical means of the properties or elements of supplies, or components thereof, including functional operation, and involves the application of established scientific principles and procedures."

[5]See: §14.101, 32 F.R. 8194 (8/26/1960) which, at the time the contracts at bar were executed, read in pertinent part, as follows:

> "(a) Inspection on behalf of the Government shall be conducted in all cases prior to acceptance, . . . Inspection shall be accomplished by or under the supervision of Government personnel . . .
>
> * * *
>
> "(b) The type and extent of inspection needed depend on the particular procurement. For example, on items which would involve small losses in the event of defects and which would probably be replaced by suppliers without contest, inspection may consist only of checks for identity, quality, and shipping damage."

The subject of discoverable defects has frequently engaged the attention of the Armed Services Board of Contract Appeals (ASBCA),[6] which has invariably employed the same test (McBride & Wachtel, *Government Contracts—Law, Administration, Procedure* (Matthew Bender, 1973, Vol. III, para. 27.60[1] at pp. 27-100 to 27-102)).

The modern view, therefore, does not consider a latent defect as simply that which is unnoticeable upon visual examination. In the procurement field, as in others, federal courts and administrative agencies have long deemed government—as a buyer—chargeable with notice of any defect discoverable upon *reasonable inspection* (*McQuagge v. United States*, W.D. La., 1961, 197 F.Supp. 460, 468; Borden, *ibid.* (n.6, *supra*), 20 Fed.B.J. at p. 152; McBride & Wachtel, *ibid.*, at p. 27-100).

"Reasonable inspection", as construed by the ASBCA, includes examination and standard testing in the industry to determine conformity to contracts specifications (See: *Appeal of J. W. Bateson Co., Inc.*, B.C.A. No. 5479 (3/29/66) 66-1 B.C.A. 25,670; 25,677 (1966); *Appeal of Dixie Printing Ink Co.*, B.C.A. No. 896 (10/28/52)).

Even the failure to inspect does not, in the Board's view, render a defect latent if it was discoverable upon reasonable inspection. Rather, the failure to con-

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[6]The ASBCA was created by a joint directive of the Secretaries of military departments and services as the authorized representative of the Secretaries to hear and determine contractors' appeals. In most cases, the Board's decisions are final; and significantly, serve, in most cases, as precedents in resolving subsequent disputes. Borden, *Effect of the Warranty Clause in Government Supplied Contracts*, 20 Fed. B.J. 151, 152 (n.5) (1960). See also: *Southwest Welding & Mfg. Co. v. United States*, Ct. of Cl., 1969, 413 F.2d 1167, 1169.

duct a reasonable inspection is treated by the Board as a waiver of the defect (See: McBride & Wachtel, *ibid.*, at p. 27-103, and decisions cited thereat).

Thus, in a case analogous to that at bar, the Board of Contract Appeals, noting the availability of practical tests for determining the hardness of a wheel, held that defects discoverable by such tests were not latent, and that the failure of the government to perform them constituted a waiver of the defect (*Action Diamond Tool Co.*, (5/25/51) ASBCA No. 625, 5 CCF 51,-887, at p. 51,888).

In contrast, the Ninth Circuit holds that the defects in the bearings delivered by petitioner were latent because not visually apparent (See: n.5, Op., App'x. A at p. 5); and even though discoverable by reasonable inspection, that is, by simple, inexpensive, non-destructive tests, such procedures were not contemplated by the contract, and hence, the government had no duty to perform them (See: n.4, Op., App'x. A at p. 4).

This rationale not only departs substantially from the standards applied by other federal circuits, and by administrative agencies which frequently encounter latent defect cases, but also conflicts with procurement regulations which define and require testing as part of the inspection procedure (see: n.4 and 5, *supra*), and which are therefore incorporated within the contract by operation of law (*G. L. Christian and Associates v. United States,* Ct. of Cl., 1963, 312 F.2d 418; reh'g. denied, 320 F.2d 345; cert. denied, 375 U.S. 954).

The Ninth Circuit's interpretation of the Inspection and Acceptance clause is particularly important here because procurement regulations frequently set forth the precise language which is required to be included

in procurement contracts as is the case, for example, with respect to the inspection provisions contained in paragraph 5 of the contracts at bar (See: §7.103-5, 32 C.F.R. 486 (1/1/72), relating to "inspection").

2. The Ninth Circuit's Construction of the Inspection and Acceptance Clause Is Ambiguous, Confusing and Unreasonable, and Applies a Double-Standard Detrimental to Future Contractual Relations Between Government and Private Industry.

The Ninth Circuit's opinion holds, on the one hand, that the government had no duty to perform tests which would have disclosed the defects in the bearings because not specifically mentioned by the contract; yet, recognizes that the contracts call for 100% final governmental inspection which the Court says is inapplicable because drawn for the government's benefit (See: p. 3 of Op., App'x. A).

The clause in question required "100% final inspection" by the government's O&R Shop "for conformance to" contract specifications. In providing that "inspection shall *in*clude magnaflux or zyglo or the equivalent thereof," the inspection clause obviously did not purport to *ex*clude other reasonable tests.

Indeed, by inserting into the contract a clause requiring 100% inspection of "all delivered articles", the government clearly was not relying on the judgment or skill of petitioner whom it knew to be merely a surplus parts dealer. The District Court found that the contractual requirement of 100% government inspection was intended by *both* parties to encompass all reasonable tests capable of disclosing non-visual defects.

The opinion of the court below offers no explanation for its thesis that a seller may not rely on the Govern-

ment's performance of a duty imposed by both contract and regulation—especially where the Seller has neither the equipment nor technical knowledge sufficient to conduct such tests itself.

As this Court has held, when the Government steps into the marketplace, it is bound by the same principles of contract construction, and is subject to the same rules governing inspection and acceptance as pertains between private parties (*Reading Steel Castings Co. v. United States*, 268 U.S. 186, at p. 188 (1925)).

Yet, the opinion at bar endows the government with the privilege of ignoring, at the *seller's* peril, a *contractual* duty to conduct reasonable adherence tests, because, says the Court, not specified in the contract; while denying enforcement rights to the seller and, in the final analysis, precluding the seller from effectively contracting for such rights (because, according to the opinion, the adherence tests provided for by the contract are solely for the Government's protection).

Such circular and ambivalent reasoning does not fairly support a judgment of nearly $175,000, nor serve as an adequate standard for the future guidance of contractual relations between government and industry.

Moreover, in holding that a seller may not rely on government inspection to disclose defects readily discoverable by reasonable testing, the opinion at bar virtually invites careless or indifferent governmental inspection, while shifting liability for the consequences thereof to private industry.

An increase of exposure to risk augers removal of marginal suppliers from competitive bidding, and increased contract prices to offset expanded potential liability and the costs incurred in minimizing it.

3. The Ninth Circuit's Opinion Presents a Substantial Question, as Yet Undecided by This Court, as to the Force and Effect to Be Given a Federal Regulation in Construing a Contravening Contractual Provision.

Navy Procurement Directive 7-105.51, which was in force at the time the contracts at bar were executed, prohibited the inclusion of warranties of adherence in procurement contracts—

> "When an inspection and acceptance test will afford full protection to the government in ascertaining conformance to specifications in the absence of defects and deficiencies."

Said regulation codified Navy procurement policy dating from World War II. Its purpose was to save the extra cost of a warranty provision when inspection procedures rendered such a clause superfluous (Navy Contract Law, 2d Ed., 1959 [Navexos P-1995], §933 at p. 556).

In 1963, the Court of Claims ruled, in what has since come to be known as the *Christian* Doctrine, that a procurement regulation requiring the inclusion of a particular clause in a military housing contract had the force and effect of law, and was therefore incorporated in such contract despite the omission of such a provision therefrom. (*G. L. Christian and Associates v. United States, supra,* 312 F.2d at pp. 424-427; 320 F.2d at p. 351; cert. den'd., 375 U.S. 954).

As the Court of Claims pointed out on rehearing, such a principle was necessary "to protect significant policies of superior administrators from sapping by subordinates." (*Christian, supra,* 320 F.2d at p. 351).

Subsequently, the *Christian* Doctrine was expanded to benefit claimants filing actions against the government (*Moran Bros., Inc. v. United States*, Ct. of Cl., 1965, 346 F.2d 590, 593).

In this case, the government brought its action on the warranty provisions of the contract. Since the government was afforded full protection by the 100% inspection clause, under the *Christian* doctrine the warranty was pre-empted by the Naval Procurement regulation which forbade its inclusion in the contract.

The Ninth Circuit held that *Christian* did not apply—

> ". . . [W]here the intent of a contract is for visual inspection and the purpose of the warranty is protection of the government against latent defects."

By this, the Court apparently meant that the inspection and acceptance clause (which required 100% final government inspection of all articles delivered by petitioner) called for visual inspection only, and hence, did not extend the government the full protection necessary to render the regulation operative.

The fallacy of the appellate court's definition of "latent defects", and with its interpretation of the inspection clause, has heretofore been noted. The view that "100% final inspection" signifies only visual inspection is a contradiction in terms, no less than it is a contradiction of the record and the regulations (See: fn. 4 and 5, *supra*), and cannot reasonably justify the Court's refusal to enforce the regulation.

Furthermore, paragraph 5(d) of the contract specifically excludes latent defects from acceptance, thereby achieving the same purpose as the warranty.

Finally, whether or not the standards and rationale of the Ninth Circuit were appropriate, the correctness of its decision is open to serious question.

The record shows quite clearly, and the District Court expressly found, that the 100% inspection clause was *intended* by the parties to require the government to perform all tests necessary to inform respondent whether each bearing delivered by petitioner adhered to contract specifications; and which should be accepted or rejected; and that the performance of such tests (as the Court's opinion concedes) would have disclosed the defects in question [Findings 3, and 12, App'x. B].

The refusal of the Court of Appeals to respect the evidence and the findings of the trial court as to the intent of the parties, the scope of the inspection clause, and the nature of the defects was unjustified, and cannot be reconciled with Rule 52(a) of the Rules of Civil Procedure, nor with the decisions of this Court, denying appellate courts that authority on a record such as here (*Walling v. General Industries Co.*, 330 U.S. 545, 550 (1947)).

Conclusion.

For the foregoing reasons, a writ of certiorari should issue to review the judgment and opinion of the Ninth Circuit.

Respectfully submitted,

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Counsel for Petitioner.

APPENDIX A.

Opinion of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals, for the Ninth Circuit.

United States of America, Appellant, vs. Franklin Steel Products, Inc., Appellee. No. 71-2428.

[July 16, 1973].

Appeal from the United States District Court for the Central District of California.

Before: HAMLIN and CHOY, Circuit Judges, and SKOPIL,* District Judge.

CHOY, Circuit Judge:

The United States sued under 28 U.S.C. §1345 to recover the contract price plus consequential damages from Franklin Steel Products, Inc. (Franklin) for breach of express warranty to provide aircraft engine bearings which conformed to contract specifications. After a non-jury trial, the district court entered judgment for Franklin. We reverse.

In 1962 Franklin entered into two contracts to furnish the Aviation Supply Office of the Department of the Navy 321 master rod bearings, Curtis-Wright aircraft engine part number 171815, at a cost of $90 each. The contracts required that all bearings be in new and unused condition and meet particular specifications, including a certain percentage of tin to reduce corrosion and steel of a certain hardness to resist stress and fatigue. Failure of the bearings to conform to these speci-

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*The Honorable Otto R. Skopil, Jr., United States District Judge for the District of Oregon, sitting by designation.

fications could cause complete engine failure and loss of both aircraft and pilots.

The contracts called for inspection by the government before acceptance.[1] Inspection procedures were to include magnaflux or zyglo or the equivalent thereof and were specified as 100% final inspection by the Navy's O & R Shop for conformance to the applicable specifications. In addition, the contract contained the following warranty clause:

> (a) Notwithstanding inspection and acceptance by the Government of articles furnished under this contract concerning the conclusiveness thereof, the Contractor warrants that at the time of delivery (i) all materials delivered under this contract will be free from defects in material or workmanship and will conform with the specifications, and all other requirements of this contract; . . .
>
> (b) Within one year after the delivery of any article under this contract, written notice may be given by the Government to the Contractor of any breach of the warranties in paragraph (e) of this clause as to such article. Within a reasonable time after such notice, the Contracting Officer may either (i) require the prompt correction or replacement of any article or part thereof (including preservation, packaging, pack-

[1]As to acceptance, the contract provided:

> . . . Acceptance or rejection of the supplies shall be made as promptly as practicable after delivery, except as otherwise provided in this contract; but failure to inspect and accept or reject supplies shall neither relieve the Contractor from responsibility for such supplies as are not in accordance with the contract requirements nor impose liability on the Government therefor.

> ing, and marking) that did not at the time of delivery conform with the requirements of this contract within the meaning of paragraph (a) of this clause, or thereafter does not so conform in consequence of any such breach; or (ii) retain such article, whereupon the contract price thereof shall be reduced by an amount equitable under the circumstances and the Contractor shall promptly make appropriate repayment . . .
>
> * * *
>
> (e) The remedies afforded the Government by paragraph (b) of this clause shall be exclusive as to any breach of the warranties in paragraph (a) of this clause, except any such breach involving latent defects, fraud or such gross mistakes as amount to fraud.

The bearings supplied by Franklin did not comply with the specifications. The tin content was unacceptable; the steel was of insufficient strength; and the part number was in the wrong place. (This last nonconformity did not diminish the functional integrity of the bearing.) In fact, the bearings were not numbered 171815 bearings, but obsolete bearings which had been replated and renumbered so as to resemble the bearings called for in the contract.

The failure to meet specifications was not discovered by the Navy until after all of the bearings had been accepted and 180 of the bearings installed in engines. The enormity of the hazard actuated the Navy to recall all engines in which Franklin bearings had been installed and to refit them with a proper new bearing. This retrofit operation cost the Navy $817 per engine ($147,060).

The district court held that the government had a duty to inspect the bearings and to determine whether they complied with applicable specifications; that by accepting the bearings the government waived any rights by its failure to discover the defects during its inspection; that the warranty provisions were superseded by the inspection provisions; and that in any case, any rights stemming from the breach of the warranty were waived by the government's failure to return the bearings or make any other demand for breach of the warranty. We disagree.

The 100% inspection clause imposes no duty on the government in favor of Franklin. A reading of the clause and the testimony at trial establish that the clause was inserted only to give further protection to the government beyond that afforded by the warranty. Franklin cannot benefit by the government's failure to take advantage of this protection. We note that this same issue was raised in *United States v. Aerodex, Inc.*, 469 F.2d 1003 (5th Cir. 1972) and was also rejected there.[2]

Even if the government were obliged to inspect the bearings, the contract specifically provides that inspection and subsequent acceptance are not conclusive "as regards latent defects, fraud, or such gross mistakes as amount to fraud."[3] The inspection failed to uncover at least three deviations from the specifications. One of

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[2]*Aerodex, supra* presents the same issues raised in this appeal. The only distinction between the cases is that the contractor in *Aerodex* was also held liable for fraud.

[3]The facts of the case suggest that the government could have charged the contractor with fraud or gross mistakes as to amount to fraud in light of the counterfeit nature of the bearings. See *United States v. Aerodex, supra.* However, since the government did not argue this theory, we do not consider it on this appeal.

these, the improper placement of the serial numbers, was patent and could have been discovered during visual inspection. Acceptance of the bearings precludes the government from now objecting to this nonconformity. But acceptance does not bar objection to the latent deficiencies in steel and tin not discoverable by visual inspection. The tests specified in the contracts, magnaflux or zyglo or the equivalent thereof, are not directed at discovering either the hardness of steel or tin content.[4] Thus, the inspection clause in no way absolves the contractor from liability for these two major latent defects in the bearings.

In any event, the contract specifically provides that notwithstanding inspection and acceptance the contractor warrants that the goods will conform wih the specifications. The warranty supersedes the inspection clause.[5] This reading of the contract applies the settled principle that in the case of an express warranty "it is no defense that the buyer, had he inspected, might

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[4]Simple, inexpensive, nondestructive tests exist by which the government could have discovered these deficiencies, but such tests were not specified in the contract. The government had every right to rely on Franklin's express warranty that the bearings would conform to the specifications. The buyer is justified in taking the seller at his word, and in relying upon the seller's statement rather than his own examination." [SIC] *Williston, supra* at 500: *General Electric Co. v. United States Dynamics, Inc., supra; Norton v. Lindsay,* 350 F.2d 46 (10th Cir. 1965); *Union Pipe & Machinery v. Luria Steel & Trading Corp.,* 225 F.2d 829 (6th Cir. 1955). While the government may have been "contributorily negligent" in not conducting a more thorough inspection, that is not a defense to a breach of warranty claim. *Brown v. Chapman,* 304 F.2d 149 (9th Cir. 1962).

[5]We see no merit in Franklin's argument that other Navy regulations should be read to supersede the warranty clause under the so-called *"Christian* doctrine." *G. L. Christian & Associates v. United States,* 312 F.2d 418, *cert. denied,* 375 U.S. 954 (1963). Those regulations do not apply where the intent of a contract is for visual inspection and the purpose of the warranty is protection of the government against latent defects.

have found out the falsity of the seller's statements" 8 Williston on Contracts, §973, at 500 (3rd ed. 1964); *General Electric Co.* v. *United States Dynamics, Inc.*, 403 F.2d 933 (1st Cir. 1968).

The question still remains whether Franklin has an adequate defense to the recovery of damages for the breach of warranty. The warranty clause itself provides for exclusive remedies in case of a breach and the government admittedly did not pursue these remedies. But this does not afford Franklin a defense to the breach of warranty claim because breaches involving latent defects are specifically excepted from the exclusivity provision. *Aerodex, supra* at 1012. There being at least two major latent defects in the bearings, government recovery for the breach of the warranty can be sustained.

Furthermore, the district court erred in concluding that the government waived its rights under the warranty clause because it failed to return the bearings or make any demand for breach of warranty. First, the bearings were not returned because they were counterfeit, and it would have been irresponsible for the government to allow them to return to the stream of commerce. At the close of the trial, Franklin agreed that the bearings should be destroyed. Second, Franklin was informed by letter of the breach of the warranty in August 1963, well within the one year period specified in the contract. Third, this suit was brought within the six year limitation period specified for contract actions by the United States. 28 U.S.C. §2415.

Finally, we must decide the measure of damages awardable to the government. The main issue presented is whether in addition to the contract price paid for

the discrepant bearings ($28,890) the government may recover consequential damages for the retrofit operation ($147,060). In *Aerodex, supra* the government was permitted to recover both such damages. While in *Aerodex* the court held that the contractor was also liable for fraud, for purposes of damages, that factor does not differentiate our case from *Aerodex* since the contracts here treat breaches involving fraud and latent defects alike.

We agree again with *Aerodex* in holding that Franklin is liable for all damages which are the direct and proximate result of the breach of warranty. *Schlottman v. Pressey*, 195 F.2d 343 (10th Cir.), *cert denied*, 344 U.S. 817 (1952). Such consequential damages may include replacement of defective goods or damages for injuries caused by these defective goods. *Grace & Co. (Pacific Coast) v. Pittsburgh Testing Laboratory*, 249 F.2d 165 (9th Cir. 1957).

The costs of replacing the bearings were necessary and reasonable. The Navy needed the bearings on an emergency basis and installed them as soon as practicable after they were accepted into airplanes necessary to support the fleet in the Mediterranean and Far East. Since the places posed a great hazard because of the defective bearings, it was essential that the emergency retrofit operation be conducted. Franklin knew or should have known that unless it supplied the government with the proper bearings such consequences would follow.

We reverse and remand for further proceedings in conformity herewith.

APPENDIX B.

Findings of Fact and Conclusions of Law.

In the United States District Court, for the Central District of California.

United States of America, Plaintiff, vs. Franklin Steel Products Company (Inc.), Defendant. Civil No. 69-1962-RJK.

Filed: April 22, 1971.

This cause came on regularly for trial on February 16 and 17, 1971, before the Court, the Honorable ROBERT J. KELLEHER, District Judge presiding, without a jury; ROBERT L. MEYER, United States Attorney, FREDERICK M. BROSIO, JR., Assistant United States Attorney, Chief, Civil Division, by LARRY L. DIER, ESQ., appearing as counsel for plaintiff, and ALBERT A. DORN, Esq., appearing as counsel for defendant, the Court having heard the testimony and having examined the proofs offered by the respective parties, and the cause having been submitted for decision and the Court being fully advised in the premises, makes its Findings of Fact as follows:

FINDINGS OF FACT

It is true that:

1. On July 30, 1962, plaintiff and defendant entered into a written contract under which defendant was to deliver to plaintiff certain aircraft bearings for a total contract price of $2,465.00 which plaintiff agreed to pay;

2. On August 23, 1962, plaintiff and defendant entered into an additional written contract under which defendant was to deliver to plaintiff additional bearings for a total contract price of $24,820.00.

3. Each of said contracts contained a requirement that the bearings to be delivered by defendant to plaintiff were to be subjected to a 100% final inspection by plaintiff at destination for conformation to certain drawings and specifications set forth in the written contracts or incorporated therein, and that said inspection would include Magnaflux or Zyglo or the equivalent thereof.

It was the intention of the parties in entering into the aforesaid contracts that the provisions set forth therein with respect to 100% inspection as that term is defined in the contracts, would operate so as to inform the plaintiff, after delivery of each said bearing, whether the same conformed to the drawings and specifications as set forth in the contracts and whether said bearings should be accepted or rejected by plaintiff.

4. Each of said written contracts contained a further provision which reads as follows:

> "Any articles delivered which have been determined to have failed to conform to the applicable specifications and drawings, or, which are otherwise considered unsuitable for its intended use shall be returned at the Contractor's expense, for replacement. The necessary replacement articles shall then be shipped, all transportation charges paid. If any of the articles returned to the Contractor are not replaced, the total amount due to be paid shall be reduced by the value of the returned article or articles."

5. The written contract dated August 23, 1962, contained a further provision which provided as follows:

> "The inspection and test by the Government of any supplies or lots thereof does not relieve the

Contractor from any responsibility regarding defects or other failures to meet the contract requirements which may be discovered prior to acceptance. Except as otherwise provided in this contract, acceptance shall be conclusive except as regards latent defects, fraud, or such gross mistakes as amount to fraud."

6. Under the terms of each of the aforesaid written contracts the plaintiff agreed that all of the bearings covered thereby would be new and unused and all would be in accordance with certain drawings and specifications as set forth or incorporated in the said written contracts.

7. Prior to the date of execution of the said written contracts the defendant, at the request of plaintiff, delivered to plaintiff at Jacksonville Naval Air Station a sample bearing purporting to be in accordance with the drawings and specifications thereafter set forth in the said written contracts. The delivery of the said sample occurred in the month of June 1962, prior to the execution of the said written contracts.

8. At the time that the said sample bearing was delivered by defendant to plaintiff, and at all relevant times thereafter, defendant was a corporation dealing in surplus aircraft engine parts acquired, for the most part, from United States agencies at surplus sales, and selling the same to users and dealers, all of which was known to plaintiff at the date of execution of the said written contracts.

9. The defendant delivered to the plaintiff prior to December 1, 1962, the number of bearings provided for under the two written contracts as aforesaid, and all of said bearings were accepted by plaintiff.

10. None of the bearings delivered by defendant to plaintiff, including the sample bearing delivered in the month of June 1962, was new, none was unused and none was in accordance with the drawings and specifications as provided in the said written contracts. Each of said bearings bore a United States Navy Part Number which was erroneous.

11. None of the bearings covered by said contracts was inspected by plaintiff in the manner set forth in the said written contracts prior to acceptance thereof by plaintiff or prior to use by plaintiff of said bearings.

12. Any defect which may have existed in any of the bearings was discoverable by plaintiff prior to acceptance thereof by means of the inspection procedures specified in said contracts; each of said bearings had a characteristic plainly visible which made such bearing non-conforming to the drawings and specifications set forth in the contracts.

13. It was the duty of plaintiff, upon delivery to it of the said bearings, to inspect the same in accordance with the provisions of the said written contracts.

In the event that any of said bearings was found by said inspection to be defective and not in accordance with the said drawings and specifications it was the duty of plaintiff under the terms of the said contracts to notify the defendant thereof, to reject such bearings and return the same to defendant.

14. None of the said bearings was returned by plaintiff to defendant at any time.

15. None of the bearings delivered by defendant to plaintiff was fit for use in aircraft engines.

16. The plaintiff installed a number of said bearings in aircraft engines without having made the tests upon said bearings provided for in said contracts.

17. Defendant, prior to delivery thereof to plaintiff, had no knowledge and had no notice that the said bearings delivered by defendant to plaintiff failed to conform to the drawings and specifications as set forth in the said written contracts.

The following conclusions of law, insofar as they may be considered findings of fact, are so found by this Court to be true in all respects. From the foregoing facts the Court concludes:

CONCLUSIONS OF LAW

1. Jurisdiction of this Court is conferred under 28 U.S.C. § 1345.

2. Plaintiff had a duty within a reasonable time to inspect the bearings covered by said written contracts, after delivery thereof by defendant to plaintiff, to determine whether the bearings complied with the drawings and specifications in the written contracts, and to accept or reject said bearings in accordance with the results of said tests.

3. After delivery of the bearings by defendant to plaintiff, under the terms of said contracts plaintiff waived any rights arising from defects or discrepancies which inspection by the plaintiff of said bearings would have disclosed.

4. Plaintiff accepted each of said bearings within the meaning of the term "acceptance" as used in said contracts; said acceptance was "conclusive" within the meaning thereof as used in said contracts.

5. Plaintiff's acceptance of the said bearings and failure, for a period for approximately six years, to offer to return the said bearings to defendant for credit or make any other demand for breach of alleged warranties, waived its rights under the contract to recover the purchase price of the said bearings.

6. Plaintiff's damages arising by reason of the installation of defective bearings in aircraft engines were proximately caused by plaintiff's failure to inspect said bearings as it was required to do under the contracts.

7. The rights of plaintiff under the warranties set forth in the said written contracts with respect to the bearings to be delivered thereon are controlled and superseded by the provisions of said contracts requiring plaintiff to inspect the said bearings and to reject those which were found defective.

8. Plaintiff may take nothing by its complaint and the defendant shall have judgment against the plaintiff.

DATED: April 22, 1971

/s/ Robert J. Kelleher
Robert J. Kelleher
United States District Judge

APPENDIX C.

Order.

United States Court of Appeals, for the Ninth Circuit.

United States of America, Appellant, v. Franklin Steel Products, Inc., Appellee. No. 71-2428.

Filed: Sept. 10, 1973.

Before: HAMLIN and CHOY, Circuit Judges, and SKOPIL,* District Judge.

The panel as constituted has voted to deny the petition for rehearing in the above case. The petition for rehearing is denied.

A TRUE COPY ATTEST: by /s/ F. Fong, Deputy.

[Seal]

*The Honorable Otto R. Skopil, Jr., United States District Judge for the District of Oregon, sitting by designation.

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No. 73-883

In the Supreme Court of the United States

OCTOBER TERM, 1973

FRANKLIN STEEL PRODUCTS, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

ROBERT H. BORK,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

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FRANKLIN STEEL PRODUCTS, INC., PETITIONER

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MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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1. The United States sued in the district court under 28 U.S.C. 1345 to recover the contract price and consequential damages from Franklin Steel Products, Inc., for breach of an express warranty that main aircraft engine bearings supplied by Franklin to the Navy conformed to contract specifications. The bearings Franklin supplied under its contracts with the Navy were counterfeits—"obsolete bearings which had been replated and renumbered so as to resemble the bearings called for in the contract" (Pet. App. 3). The obsolete bearings differed from the bearings specified in the contract in two important respects—the steel shell of the obsolete bearings was too soft, and there was insufficient tin content in a thin lead-tin overlay on the inside diameter of the bearing, the purpose of which was to lubricate the bearing while the engine warmed

up. In addition, the part number was misplaced on the bearings. The counterfeit nature of the bearings was not discovered until after 180 of them had been installed in engines being overhauled. Because of the danger of bearing failure, and consequent engine seizure, the Navy removed and replaced the counterfeit bearings, at a cost of over $147,000.

The district court entered judgment for the contractor on the ground that the misplaced part number should have been discovered on inspection by the government prior to acceptance of the bearings, and that the inspection clause of the contract superseded the warranty provision (Pet. App. B). The court of appeals reversed, noting that the warranty clause by its terms applies "notwithstanding inspection and acceptance" (Pet. App. A). The court of appeals further held that the inspection clause of the contract was inserted for the government's protection, and could not be relied upon by the contractor. See *United States* v. *Aerodex, Inc.*, 469 F. 2d 1003 (C.A. 5). The court awarded consequential damages, holding that the provision of the warranty clause limiting damages to the contract price was expressly inapplicable in the case of latent defects (Pet. App. 6).

2. The contract between petitioner and the government provided for inspection and testing by the government prior to acceptance (Pet. 4). However, the contract also provided that inspection and testing did not relieve the contractor (petitioner) of responsibility for failures to meet contract requirements discovered prior to acceptance and that acceptance would not be conclusive as regards latent defects (Pet. 5).

The court of appeals correctly held that the hardness and tin content defects were latent defects. It is

undisputed that these defects were not discoverable by visual inspection. Moreover, the tests called for by the contract would not have detected these defects (Pet. App. 5).[1] While tests exist which would have detected the defects,[2] these tests were not specified in the contract, and as a result, "[t]he government had every right to rely on Franklin's express warranty that the bearings would conform to the specifications" (Pet. App. 5, n. 4).

Petitioner's contention that the court of appeals adopted an erroneous definition of "latent defect" is without merit. Indeed, the court of appeals' decision is consistent with petitioner's suggestion that a latent defect is one "not discoverable upon reasonable inspection" (Pet. 11).[3]

The court of appeals correctly rejected petitioner's argument that Navy Procurement Directive 7-105.51(b)

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[1]The contract specified only certain tests by providing that "[i]nspection shall include magna flux or zyglo or the equivalent thereof * * *" (Pet. 4). These tests were not designed to detect either hardness or tin content of bearings and thus would not have revealed the defects in this case.

[2]Petitioner contends that the so-called "Rockwell Hardness Test" would have disclosed the softness defect. However, in *Aerodex, supra,* which also involved counterfeit bearings, the court of appeals noted that since hardness of steel is controlled at the manufacturing level, and does not vary in bearings of a given part number, the test would be used only if counterfeiting were suspected. 469 F. 2d at 1010.

[3]Petitioner contends that the government had an obligation to conduct tests designed to disclose the defects in question even though the contract specified only certain tests. While the contract could have been written in accord with petitioner's claim, it was not and the court of appeals correctly refused to rewrite it.

invalidates the seller's express warranty of conformity to specifications. That directive provided that "[w]hen inspection and acceptance tests will afford full protection to the Government in ascertaining conformance to specifications * * * no guaranty provision for that purpose shall be included in the contract * * *." The court of appeals properly held the above-quoted regulation inapplicable (Pet. App. 5, n. 5). The inspection and tests called for by the contract were not designed to afford, and did not afford, the government full protection from latent defects in the bearings.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

JANUARY 1974.

DOJ-1974-01